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The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta April 23rd, 1946

VOLUME 80

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173 Submission by Canadian Western Natural Gas, Light, Heat and Power Co. Ltd. relating to repressuring Bow Island Field, including draft contract between Royalite Oil Co. Ltd. and Canadian Western Natural Gas, Light, Heat & Power Co. Ltd. and another between Madison Natural Gas Co. Ltd., Canadian Western Natural Gas, Light, Heat & Power Co. Ltd. and Royalite, and a third between Town of Bow Island and Canadian Western Natural Gas, Light, Heat & Power Co. Ltd..... 6387

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Tuesday,
April 23, 1946.

THE CHAIRMAN: Yes, Gentlemen?

MR. CHAMBERS: Mr. Chairman, you will remember last week Mr. Fenerty asked that Mr. Mercer should go back into the box and be cross-examined as to the statements. Mr. Mercer is here now and I will recall him.

RUSSELL DANFORTH MERCER, having been recalled,

Q THE CHAIRMAN: You are still under oath, Mr. Mercer?

A Yes.

MR. CHAMBERS: I have nothing to ask him.

CROSS-EXAMINATION BY MR. FENERTY:

Q Mr. Mercer, Mr. Kirkpatrick in giving evidence in Volume 24, page 1901, in answer to the Chairman, referred to certain statements; at the top of the page:

"Q. But that is the purpose of preparing statements as far as can be done scientifically with relation to each department?

A. That is correct.

Q. So that the manager will know what is going on?

A. Exactly.

Q. And such statements were prepared in respect to the company's various operations?

A. They were prepared with respect to the total operations and broken down for various purposes.

Q. And did you have a breakdown for the production division, the oil division, the absorption plant division and the gas division?

"A. The breakdown which I am talking about, there were special statements prepared with regard to the natural gas and the gasoline operations as a combined operation and there were other statements prepared with respect to production as a whole, the gasoline, natural gas and sundry. Now this statement which I last referred to, the sundry operations, is one which is not involved with production of the gas.

Q. My point is that there are statements showing the results of the operations of each of the various divisions of Royalite?

A. That is correct.

Q. And how often were these statements prepared?

A. Once annually, to my knowledge.

Q. Do you know when the Company commenced preparing those statements?

A. I think with respect to the year 1940 or '39, I am not certain.

Q. It did not start in 1943, for instance?

A. Not the total over-all breakdown of the total operations, no sir.

Q. Was there anything special done in 1943 with regard to various departments and the breakdown of operational expenses and so on?

A. Yes, statements were prepared in 1943 with reference to the natural gas and gasoline operations.

Q. And why was that done especially in 1943?

A. That was done specially in 1943 for submission to the Conservation Board, and the matter of compensation."

And then I just want to refer you to these various references which I want to discuss with you.

Then again, - that was on April 17, 1945, and then again in June, on June 20th, Volume 28, at page 2179, the previous conversation was repeated in the evidence, that is the conversation I have just read and then it goes on:

"Q. Well those are the facts are they not, as they are written down, are they, those statements were prepared 'As far as can be done scientifically with relation to each Department'?

A. Well I did not say it in just those words. The Chairman stated the purpose.

Q. And you said "That is correct", these are the words of the Chairman of course?

A. That is correct, yes."

Then again at page 2183:

"Q. Did you have anything to do with the preparation of statements in the way of instructions?

A. No sir.

Q. To the persons preparing them?

A. No sir. My particular duties did not involve that particular branch of the accounting work.

Q. But you have been at some stage familiar?

A. I have seen them but I have never had occasion to study them or examine them, no.

Q. I think you have already told us with reference to at least one statement you prepared that costs in connection with gathering lines were allocated on the basis of gross returns?

A. I made that statement if I recall correctly in reference to statements which were prepared by the Royalite Company staff. For presentation to the Conservation Board.

"Q. That is an additional statement?

A. Yes that is a different set of statements I had reference to there.

Q. Can you tell me whether that same basis appears on the statements we have been discussing. These ones discussed in 1939 or 1940?

A. I have reason to believe they probably were but I cannot confirm that."

You see up to date we are talking of two different sets of statements.

Then in Mr. Mercer's examination. Now this is another three months' later, in September, on September 4th, 1945 in Volume 33 at page 2589, when you were being cross-examined:

"Q. And we have had evidence, Mr. Mercer, from Mr. Kirkpatrick, of the Madison Company, who said he was a former employee of the Royalite Company, my understanding of his evidence was that prior to separation of these functions, that is, the taking over by the Madison Company of the dry gas industry and some other things, that statements were prepared allocating costs of gathering wet gas between the several departments of the Royalite Company, that is, the gasoline and the dry gas industry, on the basis of 60% and 40%, that is right, is it not?

A. Well . . . . .

MR. CHAMBERS: Well you might be right but I am not very definite on that.

MR. STEER: That was Mr. Latham's evidence.

Q. MR. FENERTY: 60 to the dry gas and 40 to the gasoline operations. Now do you know yourself

" if that was so?

A. Certain statements have been prepared primarily for distribution of incomes of the several units of the Company for computation of income tax."

Then the matter was left there and a motion was taken and on the motion, in Volume 34, the following took place, at page 2674, when we were discussing what was required.

First of all we discussed this matter of 1943 and 1942 and then:

" MR. FENERTY: If the examination of the records of 1943 make it necessary, but I do not want to put you to the trouble of that if it is not necessary for you because I also want the Royalite statements showing results of the Royalite Company and departments of the Royalite Company as integrated departments of the company for those years. In addition we are asking for the production of documents referred to by Mr. Kirkpatrick in his examination before this Board. I have before me Volume 28, and at page 2179 of Mr. Kirkpatrick's examination by myself, there appears a reference, commencing at the bottom of page 2178.'

And then there is a repetition of the evidence which you had before and then just one more remark, at page 2681, a reference by my friend Mr. Chambers during the argument:

" Now these witnesses, both Mr. Kirkpatrick and Mr. Mercer, say they have not the information at hand. Mr. Kirkpatrick says Royalite has certain documents. Mr. Mercer says they are under the control, under his

control at the moment."

And then at page 2683, we have got back to where the discussions involve both the 1943 and the 1942 operations and statements, and then at the bottom of page 2682:

" MR. FENERTY: Yes, that is one statement. The other statements I referred to I do not think are amongst the documents available to Mr. Hamilton, that is these statements referred to by Mr. Kirkpatrick."

And then Mr. Hamilton says:

" If I might say a word, Sir, I saw no formal statements of account by the Royalite Company. I prepared a set of statements in '43 from the books themselves."

And then I continued:

" MR. FENERTY: I am not interested in the statement Mr. Hamilton has. If he is going to make allocations, he will be called on the stand no doubt, and testify. I am interested in the material that was available by the Board's Order and I am interested in this material with reference to which Mr. Kirkpatrick was cross-examined and was directed by the ruling of this Board to give some evidence as far as he prepared the contents, and the material that the cross-examination of Mr. Mercer disclosed today, which may or may not be included in those statements, and at the moment I will resort to the motion that I am making. I say that is elementary. If a witness can come before this Board and submit

" one basis and cannot be upset as to those various things, or the result, or anything else, by the actual material he has under his control, then I have no way of breaking him down on cross-examination."

Then Mr. Chambers again, in argument:

" MR. CHAMBERS: So far as the statements that Mr. Kirkpatrick referred to, they are in one category, but my learned friend is asking for something, whether books, special statements, documents or files from which Mr. Hamilton has compiled a statement."

Q MR. FENERTY: Now there are the various references to those statements referred to by Mr. Kirkpatrick and yourself, Mr. Mercer. Now have you got any or all of those statements referred to in this evidence?

A Those statements were prepared for a calculation of a standard profit for income tax purposes. I am sure that they will be available in rough draft. However, they were prepared only for internal purposes with the company.

Q Have you got them here today?

A No, I have not.

Q Did you have them at any time?

A They have been in the office, yes, and under my control.

Q Have you had access to them?

A Yes.

Q And is the reason you are not, the reason you have not got them here today, that you refuse to produce them?

MR. CHAMBERS: I should probably answer that. I told Mr. Mercer specifically, following our conversations the other day, that he did not need to bring any documents up.

MR. FENERTY: Not the books but I want the statements. I thought I made that clear.

MR. CHAMBERS: It is my fault that he has not them here.

MR. FENERTY: Then will you produce each and every one of those statements which I have referred to here in reading the evidence?

MR. CHAMBERS: Now there is one point I would like to raise as to that, there was some discussion as to the tax statement and the Conservation Board statement and it was my understanding, rightly or wrongly, that we were not being required to produce those because they were of no value. Now that was my understanding, I am just bringing it out now.

MR. FENERTY: Now that the misunderstanding is cleared up. . . . .

MR. CHAMBERS: I am going to ask for a ruling. I want the Board to rule on it.

THE CHAIRMAN: I have already ruled on it in my decision on the motion, Mr. Fenerty.

Q MR. FENERTY: Now let us clear one thing up so we will not have any misunderstanding because I thought there was the suggestion that those statements we were asking for were not in existence; as to all this, am I right in this, that so far as you know Mr. Kirkpatrick is correct and his evidence is correct and you were correct in your evidence when you referred to those statements?

A There were statements prepared.

Q And those statements which were referred to are still in existence?

A I am sure they are. I would have to be advised on that.

Q And they are under your control in the Company and if the order of the Board is that those documents should be produced you will go back to the office and bring them here and produce them will you ?

THE CHAIRMAN: The answer to that is yes.

A Pardon ?

THE CHAIRMAN: The answer to that is yes.

Q MR. FENERTY: As Mr. Morrison points out to me, Mr. Mercer with reference to standard profits that only became an issue in 1940 didn't it, and you will remember that Mr. Kirkpatrick has reference to statements prior to 1940, so we will have no misunderstanding without any qualifications that I am asking you to produce and what I think and submit that the Board directed to be produced is every one of these prepared statements referred to by both or either you or Mr. Kirkpatrick. Now we are quite clear what we are talking about ?

A The statements were prepared by neither of us.

Q Statements which either of you referred to in evidence.

A Those were income tax statements and as you say they came up in 1940, but the period for which they would cover was standard profits period under the Excess Profits Tax Act.

Q Let us get it clear at the moment, I am not interested in what they are prepared for. I am interested in the description of the documents in existence. I take it that you have listened to what I have read over with some care and I have been fifteen minutes with you.

MR. CHAMBERS: Not fifteen minutes with him.

Q MR. FENERTY: No. I say I have been reading fifteen minutes about the documents we are talking about and I suggest I do not have to read it again for another fifteen minutes and

those are the documents and you can sit down and check it over with me. Those are the documents I want you to bring here and hand into the Board and have them marked. Are we clear.

Q MR. CHAMBERS: Mr. Mercer, to summarize as I understand it, Royalite for the purposes of making its income tax returns and claiming for depreciation made certain computations ?

A That is quite right.

Q And in addition with respect to the standard profits, it made certain computations for the purpose of making returns or submitting to the Income Tax people. Is that right ?

A Right.

Q And then there was another statement prepared in connection with the Conservation Board under the Conservation Act ?

A Yes sir.

Q Now other than those statements what, if any other statements, has Royalite of the nature Mr. Fenerty has discussed ?

A Nothing showing complete departmentalization.

MR. CHAMBERS: Now sir, I have not the correspondence and I am bringing this up to clear up any misunderstanding that may have arisen, but you will recall about two months ago following Mr. Fenerty's letter to me, I think in October, where he listed the things that he wanted and one of the things he mentioned were certain income tax statements as I recall it and the other was a Conservation Board statement. Now rightly or wrongly I got the impression that following that discussion in correspondence that those tax statements were not being asked for. Now if I am wrong in that I accept the responsibility.

MR. FENERTY: Well I have here a page of references and whether we have some understanding or not that is the thing that both Mr. Steer and I have had always in our minds that I

have referred to now. The thing that we are waiving is the production of the books. All we are saying is the prepared statement. Let us have it. We do not ask to have you produce the books and wade into them.

THE CHAIRMAN: Well will they be of any real value to this Enquiry Mr. Fenerty ?

MR. FENERTY: I do not know sir, but I suspect so from my friend's attitude.

THE CHAIRMAN: Do not bother about that Mr. Chambers. It may demonstrate the ability of the accountants to make income tax returns.

MR. FENERTY: I may say this much, there is very interesting information available in the break down for 1943 and I think the others would be as interesting.

THE CHAIRMAN: If you want them I have said you are entitled to them.

MR. FENERTY: We want them, sir.

THE CHAIRMAN: Including the Conservation Board statement ?

MR. FENERTY: Yes sir.

MR. CHAMBERS: Now I do submit that submission was prepared in the strictest confidence and I thought the Board had ruled we did not have to produce it but we are in the Board's hands.

THE CHAIRMAN: Mr. Steer, you know something about that. Were the statements prepared by Royalite for the purpose of the Conservation Act under the order of the Conservation Board or was it done voluntarily by the Company ?

MR. STEER: No sir, they were prepared and handed to the Board in confidence for the purpose of endeavouring to reach a settlement of the dispute between the Company.

THE CHAIRMAN: Were the statements something that the

Conservation Board could have ordered to be prepared ?

MR. STEER: As a matter of law I would say not.

MR. FENERTY: I did not know the background of it.

THE CHAIRMAN: As I understand it, this Company prepared certain statements and submitted them to the Conservation Board, and I know that those statements were prepared under an agreement they were to be strictly confidential.

MR. STEER: There is not a doubt about that.

THE CHAIRMAN: I know that and so much so that Dr. Boomer, my colleague on this Board, and who was acting on the compensation case would not even let me see those statements. That is the degree to which he considered they were confidential.

MR. FENERTY: I am going to leave it to the Board, but what I am going to point out to the Board is this, that might be one reason for not discussing the matter. On the other hand the Board had directed the production of all books and documents and the books as I take it with perhaps a month or so of work, an accountant could work out a similar statement. I do not know. Maybe it is an arbitrary allocation, but if it is something that could be worked out and we say to my friend, now we are not going to attempt to cross-examine Mr. Mercer on his books and perhaps take accountants months to work out something, but if you have it worked out in the form of statements from your books, then if that is what that statement was even prepared initially for in confidence, it will give us something to work out for our clients and we could have the statements and save months of work. Surely that is a short cut that should be taken.

THE CHAIRMAN: I am not concerned with that Mr. Fenerty so much as my power to order the production of that particular

statement prepared for a specific purpose.

MR. FENERTY: That is an element I did not appreciate and I am leaving it with the Board what you think is proper under the circumstances.

THE CHAIRMAN: It becomes almost a privileged document. It is something prepared by the employees of the Company for the information of its superiors preparatory to a trial. Now lots of Judges would hold such a document is privileged.

MR. STEER: I would say sir it is exactly in the same position as a document prepared without prejudice for the purpose of bringing about a settlement of a dispute and so far as my point is concerned I would think the document is privileged.

MR. FENERTY: I won't press for that under the circumstances you have disclosed, but I think my learned friend ought to know that I cannot stop him, at least, and I will object to him if I make an argument saying that reasonable assumption should be made against the former position in the absence of proof, and my friend should not object.

MR. CHAMBERS: I have taken the position either rightly or wrongly that the Board is trying and passing on matters that arose from March 1944 on and are not sitting in judgment on what took place prior to that.

THE CHAIRMAN: Well Mr. Chambers I have ordered those documents to be produced on the ground that they are relevant. The weight to be given to them, the deductions which may be drawn are entirely a different matter altogether.

MR. CHAMBERS: So far as the tax statements are concerned I will have them brought up right away, but I did understand it and I do not want to go into the matter of correspondence which has taken place but I did understand that the Board had said

the tax statements would not be of any use.

MR. FENERTY: And the fault is probably mine and we are clear now.

THE CHAIRMAN: All right.

Q Mr. Mercer, will you get them as quickly as you can ?

Q MR. CHAMBERS: Can you get them this morning ?

A I will go back and search. They may only be lead pencil copies. As I say they were purely working copies to get a result.

Q MR. CHAMBERS: By the way, how far back do you want to go. We have filed -

MR. FENERTY: It is just the ones that Mr. Kirkpatrick and Mr. Mercer referred to.

MR. CHAMBERS: We have been filing income tax statements for years.

MR. FENERTY: Will I read it again. My recollection was that it was 1939, 1940 and 1941.

THE CHAIRMAN: '39. Is there something else we can go on with ?

MR. STEER: I have a submission prepared with respect to the Bow Island matter and Mr. Brownie is ready.

THE CHAIRMAN: Quite frankly, gentlemen, I am hoping we will be finished tomorrow and in that connection do you wish to sit morning and afternoon today and tomorrow or is there any need to do so ?

MR. STEER: I question if we need to.

F. A. BROWNIE, having been previously duly sworn, Re-examined by Mr. Steer, testified:

Q You are under oath and have prepared a submission with regard to the Bow Island situation and you might perhaps read it.

SUBMISSION REFERRED TO RELATING TO REPRESSURING THE BOW ISLAND FIELD; FREE GAS TO THE TOWN OF BOW ISLAND, NOW MARKED EXHIBIT 173.

A This is entitled:-

Submission of Canadian Western Natural Gas, Light, Heat and Power Company, Limited, (hereinafter called "Canadian Western"), relating to:

(a) Repressuring the Bow Island Field;

(b) Free gas to the Town of Bow Island.

---

1. The Agreement for the repressuring of the Bow Island Field made between Royalite Company Limited and Canadian Western, dated August 20,1930, is filed as a part of Exhibit 99. Canadian Western is prepared to purchase from Madison Natural Gas Company Limited the gas which, since 1944, has been and will be repressured and stored in the Bow Island Field at a price per M.C.F. equal to the Turner Valley well-head price established by the Natural Gas Utilities Board multiplied by the factor 0.315 (the discount factor for fifteen years at 8%) plus 2¢ per M.C.F. to cover all costs chargeable against such gas in respect to gathering, compressing and scrubbing in Turner Valley, provided that the first element of the price above set out, namely the well-head price multiplied by the factor 0.315, shall not exceed 1¢ per M.C.F.

(Go to Page 6388)

Canadian Western is prepared to purchase the said gas, subject to the making, with the Board's approval, of agreements with the Royalite Oil Company Limited whereby future withdrawals of gas from the Bow Island Field will be controlled and whereby gas is to be supplied to Canadian Western for storage. The form of such contracts has been approved by the parties, and copies are attached hereto for the information of and the future action by the Board.

2. Canadian Western brings before the Board for its consideration an agreement between the Town of Bow Island and Canadian Western dated December 12th, 1932, a copy of which is attached hereto. Under that agreement Canadian Western is obliged to supply gas up to 60 million cubic feet per year to the Town of Bow Island without charge. The consideration received by Canadian Western was that it acquired control of a gas well which, prior to the date of the agreement, had been operated by and supplied gas to the town. It seemed to Canadian Western to be essential that control over this well should be acquired if the repressuring scheme were to be efficiently operated. The agreement was originally in force for the period of five years, and was renewable for five-year periods thereafter, provided rock pressure in the Bow Island Field had not dropped below 100 pounds per square inch. While formal renewals have not been made, the parties are still performing the Agreement. The gas is delivered to the town at a point 3 miles from the town limits.

Canadian Western is advised that in all probability the Natural Gas Utilities Board would like to have in mind the terms of this agreement with the Town of Bow Island in dealing with the question of repressuring of Turner Valley gas in the Bow Island Field, of which the well of the town, taken over by

Canadian Western, is a part.

Canadian Western submits that this contract is, by virtue of Section 67 of The Natural Gas Utilities Act, to be reviewed by the Board which has power to alter it. As to events to this date, Canadian Western has received gas from the Royalite Company to be supplied to Bow Island town on terms that when the stored gas has been withdrawn and paid for under the contract of August 20th, 1930, Royalite shall then be entitled to receive credit in the Bow Island Field for a further quantity of gas equivalent to the amount supplied to the town, and as further gas is withdrawn from the field, Royalite is to be paid for the quantity so credited on the same basis as in the contract provided.

Canadian Western submits to the Board that it is possible that the effect of Board orders may be that the Company will be required to pay the price fixed at the scrubber outlet for such gas as is supplied to the town, or it may be required to pay the price fixed for gas repressured in Turner Valley without scrubbing, or in the further alternative the Board conceivably may regard the cost of supplying gas to the town as a part of the repressuring costs incurred to save producers the costs of greater compression capacity in Turner Valley for the period during which repressuring in Bow Island continues. In Canadian Western's submission the Board should decide in which of the three ways mentioned or in what other way the costs related to this free gas should be dealt with, first, during the time repressuring in the Bow Island Field continues, and second, for the following period.

It is further submitted that once the Board has determined on what basis Canadian Western is to receive the gas to be supplied to the town, it should consider whether the

contract under which the free gas is supplied ought not to be altered to the extent that the town should make some payment to Canadian Western for the gas supplied to it. Canadian Western will, at the appropriate time, be prepared, on notice to the Town of Bow Island, to make proposals in this regard.

Q Perhaps you might explain the Schedules to that submission, Mr. Brownie?

A Following the submission are two draft contracts. The first is between Royalite and the Canadian Western, which substantially deals with the matter whereby gas will be ultimately produced from the Bow Island Field, the proposal being that the gas as produced will be considered to be Canadian Western's and Royalite's jointly owned gas under the old contract, and Canadian Western wholly owned gas under the new contract, in proportion to the amount of gas stored at any time. The second draft contract is a contract between Madison, Canadian Western and Royalite whereby storage of excess Turner Valley gas will be made in the Bow Island Field during 1945 and following years. The third contract attached is a copy of the agreement between the Town of Bow Island and Canadian Western.

Q Now, Mr. Brownie, there was to be attached to that Bow Island agreement the letter which sets out the interest that the Royalite Company was to have in the gas after complete withdrawal of the amount stored by reason of the amount that was supplied previously to the Town of Bow Island, and we did not do that?

A No, we did not. As a matter of fact, I suppose we should have put that in, but it was to have been covered in the first contract here by including in the figures representing the gas stored in the Bow Island field, in which Royalite has an interest,

the total amount including stored gas and gas credited with respect to the Town of Bow Island.

Q And if my learned friend, Mr.Chambers, is not satisfied with that explanation, and wants the letter put in, we would have no objection?

MR. CHAMBERS: No, that is all right.

A These figures are subject to correction. The figures shown in the first contract are subject to correction. They were just put in the draft agreement.

MR. STEER: That is all I have to ask Mr.Brownie, Sir.

.....

CROSS-EXAMINATION BY MR. CHAMBERS.

Q Just one point, Mr. Brownie, not so much to get the information probably, but to bring it to the attention of the Board and the others. The first paragraph of Exhibit 173 suggests the discount price for the gas as such, and then Canadian Western would in addition pay to Madison as part of that price 2 cents which is designed to cover the gathering charges in Turner Valley on the scrubbing of that gas, as I understand it, Mr. Brownie? Now, Mr. Brownie, as you know, Madison is a public utility company, and that is why we are here?

A Yes.

Q And irrespective of the fact of whether the 2 cents per MCF represents the proportion of the costs of that particular gas, as I understand it your Company is prepared to make an offer of 2 cents towards the defraying of the gathering charges, is that right?

A That is right, gathering and scrubbing.

Q And that the other revenues required by Madison after deducting

the amount at the rate of 2 cents from the gross revenue, is recoverable by Madison from other customers, including the Gas Company?

A Well, I think your question answers itself, Mr. Chambers. Madison is a public utility and they have to recover the costs.

Q But what I am getting at is this, Mr. Brownie, and I am bringing it out more for the purposes of the discussion, and I am not trying to get you to admit to the point, assuming that the actual pro rata costs of collecting and scrubbing this gas to be stored in Bow Island is 2½ cents, that is what I am getting at. Now, where do you suggest that the other ½ cent is to come from, that is what I am getting at?

A Well,,Madison has to recover that other half cent, Mr. Chambers. I do not know whether I am in the position to say now where they recover it. It may be that they recover it through their rate with the Canadian Western, I do not know.

Q THE CHAIRMAN: Or some other customer?

A Yes.

Q And it may be reflected in the wholesale price?

A Yes.

MR. CHAMBERS: And, Mr. Brownie, for the year 1945, as you know, it was the Royalite that actually bought it in '45?

A Yes.

Q So that in your submission, Paragraph 1, when you refer to Madison, I take it we can assume that for the year '45 we could read Royalite in there?

A Yes, that is correct.

Q All right.

.....

CROSS-EXAMINATION BY MR. FENERTY.

Q I am not in a position to cross-examine. I do not know even whether I want to cross-examine without some consideration of this, and I think probably the time for that would be when the proposals involving the Town of Bow Island are before us, but I do have one thing I would like to ask at the moment. Is this proposal here, and these agreements, are these agreements in a form that are presently the subject matter of negotiation between the parties and are awaiting the approval of the Board, or is this simply a new proposal of the Gas Company which my friend and myself are both viewing to-day for the first time?

A Well, it has been discussed as between the Royalite and Madison and Canadian Western, and it is put forward here, these agreements are put forward in a tentative form for the approval of the Board.

Q And these figures,including the 2 cents and so on, they have the tentative approval of the Royalite Company?

A Yes.

Q And the Madison Company?

A Yes.

Q Thank you.

Q THE CHAIRMAN: And then the whole agreement is subject to the well head price?

A Yes.

Q And if the discount in price is more than 1 cent, the agreement is out?

A Yes.

MR. STEER: Unless the agreement should be approved, notwithstanding that, in the form in which it has been drawn.

THE CHAIRMAN: Quite so.

.....

CROSS-EXAMINATION BY MR. HAMILTON

Q I wonder, Sir, if I might ask this question of Mr. Brownie, bearing in mind that the total gathering, transporting and scrubbing costs are in excess of 2 cents, we will assume that, does the 2 cent figure as suggested between the two companies bear some relation to the particular percentage that might have been in mind?

A In the first instance, Mr. Hamilton, the 2 cents plus something between .63 cents and 1 cent, plus all the other charges which go against that gas by the time it is put in the ground down in Bow Island, are such that we feel that is as much as we can afford to pay for the gas and give it a cost which is roughly, which is some approximation of what gas in Turner Valley costs us today. We feel that is what the gas is worth to us ultimately. In addition to that, it does so happen that the 2 cents is some very rough approximation of one-half of the charges in Turner Valley, which was a figure mentioned in your submission, Mr. Hamilton.

Q That is incidental rather than the starting point?

A Yes.

.....

CROSS-EXAMINATION BY MR. CHAMBERS

Q That 2 cent figure in Exhibit 173 is a figure suggested by the Gas Company?

A Yes.

Q And that Exhibit 173, that is, the narrative part, is the submission of the Gas Company, and neither Royalite nor Madison

had anything to do in preparing that part of it?

A No, that is correct.

Q In other words, the discussions which you had with Madison and Royalite representatives was as to the basis of the forms of the agreements that are attached?

A Yes.

Q THE CHAIRMAN: And if this gas were being repressured in Turner Valley instead of Bow Island, there would be compression equipment required in Turner Valley which is not there now, and which is represented by your compression equipment at Bow Island, is that right?

A Yes, represented by the compression equipment at Bow Island. That is my understanding.

(Go to page 6396.).

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. HARVIE:

Q Mr. Brownie, for the purpose of the record, there are a couple of points I would like to clarify. Who pays the royalty on the free gas delivered to the town of Bow Island?

A Nobody pays.

Q No royalty paid?

A Oh, who pays the royalty. I am sorry I misunderstood you. I do not know, Mr. Harvie. I presume the Royalite. I do not know. I do not know who pays that. We get the gas delivered to us under this arrangement and that is all we know about it.

Q But you deliver the gas to the town of Bow Island free of charge?

A Yes.

Q Do you know whether your company pays any royalty in respect to that gas?

A We do not.

Q And you do not know whether any person else does or not?

A No.

Q I note in Exhibit 173, paragraphs 1 and 2, you state that the gas is delivered to the town at a point three miles from the town limits. How far is that from your main gathering point in the field?

A Well I am afraid I cannot answer that question, Mr. Harvie.

Q Roughly?

A I would say it is something less than two or three miles from our compressor station in Bow Island. It is a very short distance from one of the field lines running out to one of the individual wells, I do not recall the exact distance.

Q Then the point of the delivery to the town is, we will say, roughly three miles from your compressor station and along

the Calgary pipe line, main transportation line?

A No. No, the point of delivery - there is a pipeline running from the compressor station of the Bow Island field over to one of the wells, I have forgotten which well, which was not very far from the old Bow Island town well and as I recall it we ran a pipeline from our nearest well over to the pipeline connected to the old Bow Island town well and fed the gas into their line at that point.

Q Have you got anything to do with the gas delivered to the town under this agreement, after you deliver it?

A No.

Q You have no costs to pay in connection with it?

A No.

Q Nothing to do with servicing the town?

A No.

Q That is all done by the town?

A That is correct, yes.

.....

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. McDONALD.

Q Would you just tell me this, Mr. Brownie, as I understand your submission the Gas Company is now going to reimburse the Royalite Company for the payments made by Royalite at the rate of .63 cents approximately for gas that has been delivered to Bow Island in 1945?

A That is the proposal, yes.

Q Is there any proposal, or is there any intention on the part of the Gas Company to reimburse the Madison Company for the service of scrubbing that particular gas that was delivered in 1945 at the rate of 2 cents as set out here or any other figure?

A That was the intention of this submission.

Q That is that this 2 cents should be retroactive to 1945 also?

A Yes.

Q And that payment will be to Madison?

A Yes.

Q Now then you have used a discount figure for a period of 15 years at 8%. Was that an arbitrary matter or have you any calculations?

A That was the same figure that was used in the Royalite submissions in respect first to Turner Valley gas and also in respect to Bow Island gas and not to start another discussion on discount figures, we adopted the same figure.

Q There is a possibility that the discount period might be 18, 20 or 25 years?

A Well we have been putting in gas for 13 years now, it is 13 years, no it is more than that since we started and we have not taken any out yet, Mr. McDonald.

Q So I take it what you mean by the last sentence in the first paragraph of Section 1, of Exhibit 173, is that the amount of money actually payable by the Gas Company per m.c.f. shall not exceed 1 cent per m.c.f., which would be applicable to a field price of approximately 3 cents, is that not so?

A Yes, that is right.

Q .315 is practically one-third of the field price?

A That is correct.

Q Now just why did you arrive at that particular figure of three cents for the field price or one cent for the discounted price?

A We arrived at a figure of one cent, Mr. McDonald, because as I have stated in answer to Mr. Hamilton's question, that gives us a total cost out of Turner Valley of three cents and added to that are the other charges, our costs of storing

it and so on and we arrive at a total figure which is some approximation to the Turner Valley price for the gas currently used.

Q If I understand you right, you pay one cent for the gas and two cents for gas in Turner Valley, that makes the three cents and then your interest on your money and your compression costs in Bow Island and the administration, looking after it, would at the end of 15 years be somewhere in the neighbourhood of 7-3/4 cents, is that what you had in mind?

A Well no, not exactly, Mr. McDonald. If you added the interest burden to all that money for 15 years it would be considerably higher. I am not considering it in respect to the other items of cost, the carrying charges.

Q Then let me understand this. The investment by your Company at the rate of one cent and the two cent payment is in fact a payment out on account of gas purchased by your company?

A That is correct.

Q It would be in the nature of a general disbursement by your company chargeable in its account, a current operating expense is it now?

A No, I do not think it would be a current operating expense, Mr. McDonald. It is in part at least, in respect of gas to be used some time in the possible remote future.

Q The point I am trying to get at is this, that this .63 investment or the full three cent investment, say it goes to the one cent maximum, is not an investment by the Gas Company shareholders as part of the ordinary utility business which going to be added to the rate base and which we are going to get a rate of return on.

A You say it is not?

Q It is not.

A I think perhaps it is, Mr. McDonald. It is such an investment. It is an investment in gas for the future.

Q As I understand your previous evidence or that of Mr. Davis that the expenses of repressuring Turner Valley have always been charged to current operating expense and the payment in Bow Island, the expenses of storage in Bow Island, have always been charged to current operating expenses in the year in which they are incurred?

A No, that is not correct. I do not think I said that and I do not recall anybody else saying it.

MR. STEER: I do not recall Mr. Davies having said that.

THE CHAIRMAN: And I notice Mr. Davies in the back of the courtroom shaking his head, Mr. McDonald.

MR. McDONALD: I meant Mr. R. E. Davis.

MR. STEER: And I have no recollection of his having said that.

Q MR. McDONALD: Well can you tell me just what the procedure is? You are making this expenditure - for instance if this contract is approved the Gas Company is indebted for some thousands of dollars to Royalite and Madison?

A Yes.

Q Where would that be set up in your accounts?

A In the ordinary utility practice and the Orders approved by the Board and the City would be capitalized.

Q It would be added to the rate base?

A Yes.

Q And an investment on which the shareholders would get their rate of return?

A That is correct.

Q You tell me that was approved by the City. That is one of the matters that was negotiated between the City and the Gas Company in revisions of the Orders that were made to the rates since 1939 for instance?

A Yes.

Q Do you see any reason, Mr. Brownie, why a similar reasoning should not be applied to the storage in Turner Valley or an investment in storage in Turner Valley say of three cents, is there any reason why any party that should happen to do that should not be entitled to set up a rate base and get a rate of return upon the venture similarly to the arrangement with the Gas Company?

THE CHAIRMAN: Except, of course, it is not a public utility that is buying in Turner Valley.

Q MR. McDONALD: That may enter into it but the same principle could be applied.

A Well it all depends, Mr. McDonald. If that gas is being set up as a reserve for a good many years in the future and a public utility were doing it, I would think it might be sound practice. On the other hand, if the gas is being put in this year and part being taken out next year, it might be considered somewhat different.

Q The physical facts would have to be similar?

A Yes.

Q You think the arrangement the Gas Company has is a sound one?

A I do, yes.

Q Now I suggest to you this, Mr. Brownie, if circumstances should be such that the over-all cost to the Gas Company of obtaining gas from the Turner Valley field at the scrubber outlet should be say ten cents or twelve cents, is there any reason why the equivalent cost of this gas being repressured

or restored in Bow Island should not also increase in value so that it would be in order to accept this maximum price that you set out here of one cent per m.c.f. payable by the Gas Company currently, should there not be a relation between the two?

A Well, on the basis of my explanation, Mr. McDonald, perhaps there should be some such relationship but I would certainly want to give it some thought before making an offer along that line.

Q It occurred to me that that followed from the method of approach that you had used in this particular period of a year. Following the same principle in subsequent years, if the price should increase as I have indicated then the net, the one cent maximum which you set out in this paragraph, should possibly be greater.

A I would not want to agree with that at the moment, Mr. McDonald. It might very well be if all the elements of cost were considered in our submission here we have already gone too far. I certainly would not be a party to making a proposal to fit the thing exactly to the Turner Valley price without further consideration.

Q Now was I correct in understanding you to say that the two cents per m.c.f. figure used in paragraph one of Exhibit 173 was roughly one-half of the four cents approximate figure used by Mr. Hamilton's submission?

A Very roughly, yes. It is somewhat in excess of the four cents but that is a rough approximation.

Q The intention was that that two cents should have some relation towards the cost or the figure you set ?

A The primary intention was to give us an over all figure which we thought was a fair charge against this gas. It did develop that such a figure did permit us to offer two cents with respect to that element of cost and it further developed that that two cents was a rough approximation of the cost of gathering.

MR. HAMILTON: For the purposes of the record, I think I should say here that I did not suggest anything in the way of an estimate of four cents.

WITNESS: No. The reference I made to what Mr. Hamilton said was that he more or less arbitrarily used one-half as the fraction to be charged against Bow Island gas.

Q MR. McDONALD: What I had in mind was this, when I was thinking along the same lines as your negotiations, take the gathering costs of Madison Gas and increasing it by the scrubbing cost, the adjustment would be somewhere in the neighbourhood of four cents and 50% of that would be two ?

A Yes.

Q That was roughly the calculation you had in mind ?

A Well, no, not exactly, Mr. McDonald. It worked the other way. We started out with what we thought we could afford to pay and then in proportion to that figure we checked it to see what it looked like as compared with the scrubbing and gathering costs and it looked like about one-half.

Q Well in arriving at this figure then you worked according to this, the suggested costs of gathering and compressing and scrubbing gas in Turner Valley ?

A I am sorry, I do not understand that.

Q I am referring to Mr. Fenerty's question to you, he led you to

agree with him that two cents is roughly the gathering and compressing costs in Turner Valley, that that is what they should be and that is all they should pay for it, you did not go that far ?

A No.

Q And in arriving at this two cent figure you are not suggesting that is your opinion ?

A No.

MR. McDONALD: That is all I have.

THE CHAIRMAN: Mr. Blanchard ?

MR. BLANCHARD: There is just one matter which I would like to consider, sir, if I might, rather than prolong the Hearing now, and perhaps if I have anything further to ask we can recall Mr. Brownie.

THE CHAIRMAN: Certainly. Mr. Fenerty is in the same position. He wants to consider the agreement and then if he has any cross-examination he wishes to have it later.

MR. BLANCHARD: Yes, I will ask to have him recalled if there is anything further that I wish.

THE CHAIRMAN: Now let me see, Mr. Steer, if I understand this matter correctly. There is an application for approval by the Board of the agreement between Royalite, Madison and the Gas Company and that approval cannot be given until such time as matters of prices have been determined.

MR. STEER: Quite so.

THE CHAIRMAN: And then depending upon the No. 1, will come the agreement with Bow Island which is an application to vary an existing contract.

MR. STEER: We are not making a formal application.

THE CHAIRMAN: At the present time ?

MR. STEER: Not at the present time and whether we do or not will depend upon the view which the Board takes in the matter. We have agreed to pay, to give value to the town of Bow Island, for the preservation of a site for storage fuel and it may be that the Board may think that that is a proper charge against repressuring.

THE CHAIRMAN: And that will be a matter to be determined later on ?

MR. STEER: Yes.

THE CHAIRMAN: After the details of No. 1 have been settled ?

MR. STEER: Yes.

MR. CHAMBERS: There is this matter, sir, that has occurred to me: Bow Island gas is in fact being repressured or will be repressured shortly and most of it will be gathered in 1946, by the time the Board's judgment is out I imagine and I am wondering if there is any necessity for an interim order.

MR. STEER: Could not the existing order be continued until this question is settled ?

MR. CHAMBERS: The order is not binding on Royalite and Royalite is not mixing in this this year.

THE CHAIRMAN: Until the new agreement, Mr. Chambers, there must be some status quo, some status quo must be maintained under either a Board order or the old order.

MR. CHAMBERS: I suggest that the Board should make an interim order. Not necessarily take out the formal order but just have it on the record that we should continue on this arrangement pending a final decision of the Board.

MR. STEER: The difficulty about that is that you are

certainly adding another character to the gas in that area which has to be dealt with and my suggestion is that the present arrangement might well be continued if the parties to it think it can be done in that way until this question is settled.

THE CHAIRMAN: What is the number of that order ?

MR. STEER: 15 and 16 I think.

THE CHAIRMAN: Oh yes, now Mr. Brownie, you may be recalled for cross-examination by Mr. Fenerty and Mr. Blanchard and I have no doubt by that time some one else will have thought of something else that they will want to ask so the door will be wide open again.

WITNESS: That is all now then ?

THE CHAIRMAN: Yes.

Now is it the intention to have Mr. Hamilton make his submission before Mr. Mercer's cross-examination is finished or should we wait ? Shall we have it now ?

MR. CHAMBERS: It does not make any difference to me.

THE CHAIRMAN: Mr. Fenerty ?

MR. FENERTY: It is immaterial to me also which way is followed. If Mr. Mercer is not here perhaps Mr. Hamilton could go on.

THE CHAIRMAN: I have an objection to wasting time, so Mr. Hamilton, will you please take the box.

ROBERT WINSLOW HAMILTON, having been recalled, direct examination by Mr. Blanchard, continued:

Q MR. BLANCHARD: I will let Mr. Hamilton just give what evidence he has.

THE CHAIRMAN: Have you something to read, Mr. Hamilton, as well as the figures ?

A I thought perhaps it would save time so I have just prepared a short memorandum and I have only two extra copies.

Comments regarding statement submitted regarding Royalite Operations for 1943

Pardon me, sir, I do not think this has been marked yet as an Exhibit.

MR. BLANCHARD: No.

THE CHAIRMAN: The statement you are now reading and the figures will be one Exhibit.

MR. HAMILTON: I do not know that you need to make an Exhibit of this first statement.

THE CHAIRMAN: No, I do not think so. Then we will just mark the statement, the statement of figures will be Exhibit 174.

STATEMENT PRODUCED HERE MARKED AS EXHIBIT 174.

In tendering this departmentalized statement of profit and loss of the Royalite Oil Co. for 1943 the following points should be mentioned:

1. The principal reasons for making the study were as follows:
   (a) To form an opinion as to the profitability of well operation - particularly of gas wells.
   (b) To compare the operating results of the gas division of Royalite prior to regulation with the operating results of Madison under regulation.

(c) To form an opinion as to the profitability of absorption plants.

(d) To consider the propriety of the various bases used for determining inter-company charges for materials and services, - having in mind that the Madison company under regulation, despite its legal severance, continued to be a member of the Imperial family and its operations in many respects were and would be integrated with the operations of its parent company and affiliates.

2. The year 1943 was selected for the reason that it was the latest full year at the time of our study.

3. The company does not itself departmentalize its operating results in its books nor are its books so kept that such an analysis can be conveniently made so as to show the profitability of its absorption plants, gas division or well operating and other activities, except in an arbitrary and approximate fashion.

The books do show the revenue from various sources, such as gas sales, gasoline sales, drilling credits and so on, but the revenues so shown are limited to revenues of the company as a whole, and credits are not reflected for certain substantial inter-departmental transfers such as for example, the value of dry gas furnished by the wells to the gas division. Incidentally, however, it does put through transfers for fuel gas. Adjustments had therefore to be made with regard to these interdepartmental transfers.

On the cost side, the company endeavors to determine the prime cost of operating each of a great variety of service units and the cost so determined are then distributed

to primary operating departments and/or other service units on such bases of distribution as appeared most reasonable. To be more specific, the service units for which costs are determined for subsequent distribution, are such as

Boiler plant	construction tools
Electric plant	gravel crushing
Turner Valley office	ditching machine
Engineering	garage
Laboratory	Water system
Mud pit and loader	residential quarters
Pipe straightening machine	store house
Blue printing	forge and machine shop
Cardwell pulling unit	

and there must be two or three dozen more.
This list is illustrative but by no means exhaustive.

The costs accumulated under each of these heads are restricted to what might be called prime costs and do not for example include such elements as depreciation, employees welfare, administration and taxes, for which no distribution is made in the accounts. Consequently the cost of steam charged to say the #1 gasoline plant is not the full cost of steam but the cost exclusive of boiler house depreciation and taxes and other elements. Moreover the costs charged to the boiler plant would include a portion of the expense of running say the laboratory and the Turner Valley office which would themselves be understated because depreciation, taxes, administration and welfare costs have not been distributed. As a result the boiler costs would be further understated, and the costs of every department serviced by the boiler plant would be correspondingly understated.

From these remarks it will be seen that to make the necessary adjustments to arrive at the profit of a particular operating department would not only be a very laborious mechanical process but would involve a number of decisions on which differences of opinion would lead to substantially different results.

Wherever a method of distribution was clearly indicated in the accounts we adopted it. Where no method of distribution was indicated we adopted such a method as seemed to us most appropriate having regard to the circumstances and after the fullest discussions with employees of the company who gave us every co-operation in this regard but who may not necessarily concur in the conclusions we came to nor in the accounting procedure to which those conclusions brought us.

Now, sir, we might have a look at the statements themselves. I can run through them briefly and perhaps add a comment here and there which might be of assistance.

The first page of Exhibit 174 is a summary of the profit and loss account of the Royalite Oil Company, showing the departmental profits, each of which profit figure by departments is borne out by one of the attached schedules.

The total departmental profits amount to $1,270,208.72 of which the gas sales division, and by that I mean the dry gas business as it is called sometimes, roughly is accountable to the operation of the Madison Company for $381,463.11; the two gasoline plants showed a departmental profit of $325,644.23 and the production division a total profit of $563.101.38.

To that there was added on our basis some

some incidental non-operating revenue aggregating thirty-three, almost thirty-four thousand dollars made up of dividends, interest and royalties, bad debts recovered and gain on sale and retirement of certain fixed assets which could not be definitely associated with any one of the primary per ting departments.

We have then deducted certain non-operating or extraordinary costs and expenses amounting to two hundred and thirty thousand dollars.

The first of those items is a portion of the pension fund contribution of forty-three thousand dollars, which we felt to be excessive as applicable to this particular year. The total amount provided in the accounts was fifty thousand and we considered that approximately sixty-seven thousand or rather sixty-seven hundred, was a fair and normal operating charge and the residue of the forty-three thousand would be deemed to be a fixed contribution to the scheme in respect to arrearages.

One hundred and twelve thousand has been provided as the share of the Dalhousie deficit, I mean of the subsidiary company of Royalite, and the next item amounting to fifty-five thousand represents our estimate of under charges to other companies, mainly affiliated companies, and I might say in that connection, as I have previously illustrated, it was an attempt of the Company to determine the costs of performing a number of different services and was their further attempt to distribute that cost to those receiving the servicesand in a great many cases the persons receiving the services would be companies other than the Royalite Company itself.

By reason of the fact that all costs were

not charged to those service units and in particular I am thinking of administration, employees welfare, depreciation, taxes, the result is that you arrive at some figure of this order of fifty-five thousand, which represents the amount that perhaps would have been recovered or attempted to have been recovered by the Company from its affiliates had its old true costs been determined in the first instance for each of these functions.

The next item of nineteen thousand dollars represents the portion of the recorded loss on certain lease cancellations which were booked in 1943 but the total gross values of the leases were twenty-nine thousand eight hundred dollars and we estimated that the reserve for depreciation or depletion rather would have been about nineteen thousand four hundred and fifty dollars and that amount has been disallowed as, - for this purpose, as a charge against the production division.

(Go to Page 6413)

The net profit before taxes on this revised basis is the same as that shown by the Company itself, $1,073,665.32, subject to tax $326,089.94. The residual income after tax $747,575.38, which again is the Company's own reported figure in public accounts for the year 1943.

Schedule 1 to this statement is a computation of the net departmental profit of the gas sales division on the basis of roughly comparable to the operations of the present Madison Company. The total dry gas sales in that year fetched, $1,004,668.69, an average of 7.056 cents per Mcf. From that there is deducted an amount of $278,000 odd leaving the value of the gas acquired either by purchase from outside companies or by transfer from the production division of the Royalite Company at a imputed price of two cents. Adjustment has been made for fuel gas sales and for fuel gas supplied by this division to other activities of the company. And I have mentioned a moment ago that whereas the Company does not reflect or did not reflect a transfer from the production department to the gas sales division of the gas that was to be sold to the market, it did show the effect of fuel gas at a price of two cents for unscrubbed gas and two cents plus a further two cents, or four cents in all, for scrubbed gas. After deducting the purchase value of the gas sold from the sales proceeds we have left $725,000 odd to cover operating costs and profits and the next section of the statement deals with the classification of the expenses as between operation, depreciation, taxes, loss on sales and retirements, according to functions. The gathering in the north, the gathering in the south, compressor station #1, compressor stations #2 and 3, and the scrubbing unit. The costs are added both ways, so that we have the gross gathering costs

of $80,000.00, compression costs of approximately $104,000.00, scrubbing costs of $219,000.00 or $406,000.00 all told. Of which $309,000.00 is operating costs. $93,000.00 depreciation, and $4,000.00 taxes with a net gain on retirements of approximately $800.00.

There has been deducted from these gross operating costs an allowance first of all for scrubbing at two cents, which has been deducted from the scrubbing costs, and second, an allowance for gathering and compression to be transferred to the account of the gasoline plant for the services rendered by the gas division in gathering that portion of the stream which is processed or is extracted at the absorption plant.

The particular calculation here has been made at 5.83544%, which represents the actual statistical relationship for the year 1943 of plant vapors and shrinkage to total wet gas gathered. This compares with the Royalite submission R-6.

MR. CHAMBERS: Exhibit 156.

A Thank you. Of 7.87%, but I have already adjusted separately for the fuel and consequently their figure would be higher than ours. Fuel, I take it, is the difference between our two percentages. In other words, sir, this transfer to the gasoline plant has been made on a volumetric basis and I am not suggesting nor was I that was the only or best way of doing it. The information is there from which any calculation can be made and I used this one because I knew it was the method to be urged by the Company itself and secondly, because it was the one which would be most difficult for someone else to get at if he did not have the precise information.

Schedule #2 is a presentation of the operating results by the gasoline division showing the total absorption plant operation and then in columnar form the separation operation of each of the two plants.

I should say that the gasoline plant #2 operated for ten months only of that year and gasoline plant #1 of course operated for the full year.

The deduction from sales for share going to producers includes of course inter-departmental credit which was an arbitrary calculation made by ourselves for what we consider would have been paid to the producing division of the company itself, had they been separately owned.

The depreciation figures I perhaps might have mentioned this before. We did not change depreciation calculations in any way throughout. As a matter of interest I might mention this, that we have for gasoline plant #1 depreciation of $13,000.00 which is, of course, in accordance with the books and Mr. McLellan's figure in Exhibit 156 was $14,900.00. Those figures are roughly comparable to, I doubt whether they were on exactly the same basis, and for plant #1 the depreciation recorded in the books and which appears here of $22,264.00, and Mr. Mc Lellan's figure of $4,137.00, the overall operating result shown by Mr. McLellan in his Exhibit 156 for gasoline plant #1 was $257,000.00 as compared with my figure here of $374,000.00. A difference of approximately $117,000. That difference of $117,000 is largely accounted for by the item of $96,000.00 which was the amount subsequently paid, I understand, by the Royalite under the compensation scheme which in Exhibit 156 they treated as a charge against the absorption plant. A treatment which in my view was not altogether

sound, but I believe that matter has been fully discussed on another occasion.

A further difference of $22,000.00 exists between Mr. Mc Lellan's presentation and this one as to the sales figure. My sales figure of $602,000.00 includes, I am informed, an amount of $22,000.00 odd which represents revenue which came in during the year 1943, but which actually related to a prior period.

In connection with the gathering and compressing costs transferred into this operation from the schedule I have just previously discussed, I should perhaps have mentioned that the percentage of 5.8% of gathering and compressing costs applies only in the case of #1 plant and relates to gathering north and compressor #1. Whereas, in the case of the #2 plant, the whole of the gathering and compressing costs for five-sixths of the year was deemed chargeable to the absorption plant because none of the dry gas taken off at #2 plant reached or was intended to reach the market.

Schedule 3 is a break down of the operating results of the production department showing a total departmental profit of $563,000.00 of which we estimate $242,000.00 comes from the operation of wholly owned wells. Approximately, two hundred thousand from Royalite's share of partnership wells and $125,000.00 from drilling operations of which $78,000.00 accrues from royalties received with respect to prior years' drilling contracts. From the total of those there is to be deducted loss on operating contracts of approximately $4,000.00.

The second column of this schedule 3, dealing with wholly owned wells is further developed in schedule 4, in which the total operation of the wholly owned wells is

broken down between crude wells and gas wells and the information there contained is related to some calculations made as Exhibits presented in our Exhibit 124, specifically statements WH-57 to 64.

THE CHAIRMAN: Anything further, Mr. Blanchard on this submission ?

MR. BLANCHARD: No sir.

(At which time a short adjournment was taken)

CROSS-EXAMINED BY MR. FENERTY:

Q Mr. Hamilton, I just want to see if I understand this. In Schedule #1 as I understand it now dealing with the south gathering and #2 and #3 compression. The way this set up is on the basis of the cost and charges of handling the gathering being charged for 100% for the ten months in the south end of the field ?

A To be specific the figure of $26,517.68, if I recollect, correctly represents 5/6 plus 5.8% of one-sixth of $31,821.22.

Q But the way you arrive at that is you charge all of the gathering costs and compression costs for ten months ?

A Yes sir.

Q And then you divide the costs for the remaining two months on the basis of 5.83% to the absorption plant ?

A Yes sir.

Q And the 94% or whatever it is point something to the gas ?

A Yes sir.

Q That is because it was operating for ten months in the south end and two months in the north end ?

A Yes sir.

Q THE CHAIRMAN: What is that figure of $26,000.00 you

spoke of ?

A It is the red figure under gas gathering south, sir. The same calculation applies in the column second over from that under compressors 2 and 3.

Q MR. FENERTY: Now I just want to get that again. There is 100% of these gathering costs we will say charged for the ten months when the plant was in the south end of the field and then that is almost reversed with 95% charged to the gas division and 5.83% charged to the gasoline division for the remaining two months ?

A Yes sir.

Q And as far as you know the function, the mechanical operation, of the entire operation of that plant in the south end of the field is the same as it was in the north end, as far as gathering is concerned ?

A No sir, I think there was a difference.

Q What I am getting at is it was just wet gas gathered from wells and delivered to the absorption plant ?

A Yes sir.

Q That was the same both in the south end of the field and the north end of the field ?

A Yes sir.

Q And by virtue of the fact that there is a market for dry gas through the absorption plant you practically reversed the costs, all but 5% ?

A It raises a rather curious anomoly there and if I were to do it today I would do it differently.

Q Well that is exactly the same function that is delivering from wells to the absorption plant ?

A Yes, with this qualification. After it was tied into the #1

plant the south gathering system was operated with slightly different factors in mind.

Q But the mechanical function is exactly the same ?

A Yes.

Q And may I ask you did it require any mental agility on your part to reverse that situation, switch it around and reverse the charges ?

A I am not sure that I follow you sir.

Q What I want to know is I gather from you for instance that changing the leopard's spots would not be a particularly difficult operation ?

A I do not follow you sir.

Q What I mean is you have the operation of gathering wet gas from wells and you deliver it to an absorption plant and for ten months of the year you charge it 100% to the absorption operation ?

A Yes sir.

Q And you perform exactly the same operation in the north end of the field and for two months of the year you charge 95% to the down stream dry gas product ?

A I do not say it is exactly the same situation for the last two months, but I do say if the volumetric method is correct and I doubt whether it is, this is as close to an accurate interpretation of that principle as it is possible to get if you accept the premise that the volumetric system is the correct one.

Q You were not doing this to show the absurdity of the situation by any chance ?

A No, not necessarily.

[illegible]

[illegible]

[illegible]

Q Not necessarily?

A No.

Q I see. I am still going to thank you for doing it, Mr. Hamilton. Now, I want you to picture with me for a minute or two the situation that would arise in connection with the absorption plant operations in the North end of the field, on the basis put forward by the Gas & Oil Products Company in their submission. You remember what they had in their submission, referring to where they were in the South end of the field, and suggest that if these gathering costs were properly chargeable to the absorption operations, you remember that?

A Yes, that is right. I should say, provided that the revenue for gas goes to the absorption plant.

Q Provided that the revenue for the gas goes to the absorption plant?

A Yes.

Q And divided between them and the well owners?

A Yes sir.

Q Take the Dry Gas Division of the Royalite Company, as analyzed in this statement for 1943?

A Yes.

Q And you have the gathering and compression costs set out in these various figures, 49,000, 31,000, 75,000 and so on, the first four columns of the exhibit there, leaving out the scrubbing, I am not concerned for the moment with the scrubbing at all, a total sum of $186,471.65. I am going to refer to thousands now, calling it $186,000.00. And as we interpret it there has been charged to the absorption plant in the way of costs, $58,000.00?

A Yes sir.

Q And charged to the dry gas, $128,000.00?

A Yes sir.

Q And the profits for the Dry Gas Division are $381,463.00?

A Yes sir.

Q Now, I want to follow with you the result if all of the costs, that is that additional $128,000.00, had been charged to the absorption plant, do you see, on the basis of an absorption plant operation, and you get, I think, five hundred and nine thousand odd dollars. You see, three hundred and eighty-one thousand profit, there is that profit there. Now then, the $128,000.00 which was charged to the Dry Gas Division for operating costs, if that had been taken out of the Dry Gas Division and charged to the absorption plant, you would have that additional profit, wouldn't you?

A Yes sir.

Q For a total of $509,000.00?

A Yes sir.

Q And the rate base, the Dry Gas Department based on book values and book depreciation, as set out in Exhibit 124, comes to $789,000.00 odd?

A The rate base?

Q If that basis were adopted.

Q THE CHAIRMAN: One or your suggested rate bases?

A Yes sir.

Q MR. FENERTY: Exhibit 124, the first one at page 3, W-H-3, the fourth column, Net Book Value $789,000.00.

A Yes, I just wanted to make sure that it was not the rate base, that is all.

Q So that on the basis of book values, the costs of gathering and compression, charged to an absorption plant before the Income Tax, should have five-eighths of the whole thing, of the total book value in one year?

A On those assumptions,yes sir.

Q Now, let us see what it would do to the absorption operation if it were charged that way. You have here a net profit of $325,644.00 on your figures?

A Yes sir.

Q And you have this $128,000.00 of operating costs, which you have charged to the Dry Gas Division, and I am suggesting that we transfer it to the absorption plant, so that that would be an additional expense, and that would leave you one hundred and ninety-seven thousand odd dollars net profit after bearing all gathering and compression costs,wouldn't it?

A Yes sir.

Q On the investment, as I have it here, in the Gasoline Department as of the 31st of December, '42, so far as the unit method of depreciation is concerned, as set out in Exhibit 156, amounts to eight hundred and eighty-five thousand dollars odd. That is in Statement No. 1 of Exhibit 156. Just take that figure?

A I will accept it.

Q $197,000.00 profit after all expenses charged, and with the investment in the Gasoline Department with the unit depreciation, according to my figures, that works out before income tax of some 22.3% profit. Now you have not checked that?

A It would be on that order.

Q And you would say that is quite a handsome profit?

A I wonder if you are overlooking the capital loss sustained in the closing down of the No. 2 plant.

Q That is the actual figures?

A Are you overlooking the closing down of the No. 2 plant which closed down on October 31st of that year, and there would be a substantial capital loss accruing thereby.

Q I think the only thing we have overlooked here is several

expenses that you say have not been charged?

A No, I still think there is a very important element to be taken into account, and that is the capital loss which accrues from the closing down of the No. 2 plant as a necessary element of consolidation.

Q I am speaking of the year's operations?

A Yes sir.

Q Based on that figure of value as of the 31st of December, '42, the actual value?

A Yes sir.

Q And it works out to 22% on the basis of actual value, and with all operating costs charged against the absorption plant?

A Yes sir, but there is a capital loss accruing from the closing down of the No. 2 plant. In other words, you have your operating expenses on the one hand, and your capital loss on the other. However, your conclusion is correct arithmetically.

Q You say that you have a capital loss because of the closing down of the plant?

A That is my view, yes sir. There was a substantial element of investment in the No. 2 plant.

Q Wouldn't you call that obsolescence, or obsolescence would not be involved in there?

A There are a number of different points of view that could be put forth with regard to it, but whatever you call it, there was a loss there that accrued in 1943.

Q If it is a capital loss it is a capital loss because this plant is not worth as much because of being moved, is that it?

A Perhaps at the moment all I want to say is simply that you must not overlook that there was a loss of some kind, however you want to describe it.

Q But that would be balanced by the fact that the plant is not

worth as much if there is a loss.

A That is why there is a loss.

Q So that the two would balance each other, wouldn't they, and perhaps over-balance from my point of view?

A All that I am saying, Sir, is by reason of a consolidation there is an investment in the No. 2 plant which is vacated.

Q Let us drop for the moment this nebulous possible capital loss and obsolescence and so on, which may be made against that computation, and I am suggesting to you that on this actual valuation, which I now understand you to say might be too high, that there is 22%?

A I will agree with you, but what is its actual value? I believe the premise that you use does not indicate the value.

Q It might be too high if there is a capital loss, but I am willing to take it at the highest figure, there is 22%?

A All right.

Q Yes.

A Arithmetically, I ageee with you.

Q And you, of course, are unfortunately unable to tell us whether the situation is as favourable to the Royalite in the other years? You have not examined it?

A I would assume it would be less favourable.

Q Do you think that was a good heavy year? I mean, taking it in the preceding years, '42 and '41?

A In the year 1942, '41 and '40, I would assume that the Royalite operation in the Gasoline Division would be less favourable, less profitable, due to the lower throughput. There would be previous years to which the situation would be reversed.

Q I see. Are you able to tell us, or even hazard an opinion as to what the percentage of profit would be in an absorption operation if instead of a unit method of depreciation the

actual depreciation taken on the books of the Company was used?

A Well, it is the depreciation actually taken on the books of the Company.

Q You are only using the unit method of depreciation here?

A But my figures are based on the actual depreciation, however, not on the unit.

Q I am speaking now of the absorption plant. The figure I gave you of the dry gas operation was the actual book value, I mean, book depreciation, the book depreciation and historic value. That was the figure we discussed on the Gas Division, that was the seven hundred odd thousand dollars, but on the absorption plant operation, the figure we have here of $885,000.00 is the investment in the Gasoline Department as of the 31st of December, 1942, using the unit method of depreciation, and that is set out in Exhibit 156 of the Royalite Company?

A Yes sir.

Q Now, I say that works out, disregarding for the moment the discussion of capital gain, that works out at some 22% return before income tax, and after charging all gathering and compression costs to the Gasoline operation. Now, I ask you if you have any idea what percentage that would be, if instead of the unit method of depreciation there had been taken the book depreciation applied to that figure of $885,000.00?

A I perhaps would point this out, Sir, and that is that you are using book depreciation in determining the operating costs and unit depreciation in calculating the investment.

Q Yes?

A And you get into peculiar conclusions in so doing.

Q I guess that is right. I am off the track, I guess?

A No sir, it would be a useful conclusion.

Q Let me get this, have you been able to form any estimate from the annual statements of this Company that you have seen, the Royalite Company?

A Yes sir.

Q As to the write-off, the percentage of write-off covering everything, including the drygas and the gasoline operations, 65, 70%?

A Do you mean what is the total accumulated reserve for amortization, depreciation and depletion?

Q Depreciation taken, I will use those words, depreciation taken by Royalite as shown by its statements, I like those words, "depreciation taken"?

A I am not clear as to what you mean, depreciation on such things as are subject to depreciation, or depletion and amortization too?

Q Well, as I understand in your statement you cannot separate those, but what I am getting at is this, can you tell me anything from the statement showing the percentage of depreciation on everything, including that part which now is a matter of a public utility?

A When you say everything, you just mean the plant depreciation?

Q Yes, the plant?

A You are not talking about wells now or leases?

Q Well, I do not know whether it includes those or not. No, I am speaking now of the plant. I have got the impression that it was somewhere between 65 and 70%, and I wondered if you knew?

A As at December 31st, 1943, and I am speaking now of general equipment.

Q Yes?

A Which I assume is the type of thing you are talking about?

Q Yes, that would include this equipment we are referring to?

A Yes sir.

Q Yes?

A But does not include wells and leases?

Q No, I understand that?

A The total book cost to December 31st, 1943, of this class of asset was in the order of $4,900,000.00, and depreciation had been recorded of $3,800,000.00, leaving a net book value of $1,100,000.00, as at December 31st, 1943.

Q Well, perhaps this is the figure I want in your report, Mr. Hamilton, Exhibit 124, W-H-3. I see in the second column here "Depreciation 50.10%"?

A Yes sir.

Q Now what I want to get at is if you were to apply that figure to the investment in the Gasoline Department, and that is adopt a book depreciation rather than your unit method of depreciation, would it substantially reduce this valuation of $885,000.00? Let me show you, Mr. Hamilton?

A Which $885,000.00?

Q This computation of $885,000.00. On the basis of values of the absorption equipment with the unit depreciation. Now, I do not know whether the book depreciation amounts to more than the unit depreciation, or less, I am just trying to find out?

A No, it would be more, the book depreciation would be more than the unit depreciation.

Q It would be substantially more?

A Yes sir.

Q So that if you use the Royalite Company's own figures, this percentage of profit of 22% would be very much larger?

A On all the assumptions, yes, it would be higher.

Q In other words, we had decided that this was a handsome profit, and that then would be a much more handsome profit?

A You said it was a handsome profit. I did not agree with you.

Q I suggest to you that it would be, and didn't you agree with me?

A I did not agree with your assumptions altogether on that.

Q I thought you agreed with me. On a book method it would be clearly a handsome one, wouldn't it?

A On your assumptions, yes sir.

Q Thank you.

THE CHAIRMAN: Mr.Steer?

MR. STEER: No questions, Sir.

THE CHAIRMAN: Mr. McDonald?

MR. McDONALD: I haven't any questions, sir.

THE CHAIRMAN: Mr. Harvie?

MR. HARVIE: No questions.

THE CHAIRMAN: Mr.Chambers?

.....

CROSS-EXAMINATION BY MR. CHAMBERS.

Q Mr. Hamilton, I think you told us in your opening statement, and just to draw your attention to it I am reading from the notes that you have been kind enough to loan me, taking it when you were talking about the statement, "From these remarks it would be seen that to make the necessary adjustments to arrive at the profit of a particular operating department would not only be a very laborious mechanical process, but would involve a number of decisions on which differences of opinion would lead to substantially different results."

As I take it those remarks apply to your Exhibit 174?

A Yes sir.

Q And that Exhibit 174 is not intended as the way it should be set up if it were bringing it under regulation for the first time, if you were bringing the absorption plant under regulation, or was under regulation in 1943, we will say?

A No sir.

Q And I am suggesting to you, Mr. Hamilton, that the same remarks that you have made will certainly be applicable to any statement that would in the ordinary course of business be prepared and submitted for income tax purposes, wouldn't it be reasonable to assume that?

A Oh yes sir.

Q Now, as I understand it, statements for income tax purposes have to be prepared with respect to allocations mainly on account of the depreciation and depletion claim, is that right?

A I do not know, sir, why these statements were prepared. It might be for a variety of reasons. I have not seen them. I do not know what purposes they serve.

(Go to page 6430.).

Q Well I am asking you aside from this particular statement in a company such as Royalite operating various businesses why do you as a chartered accountant say that if circumstances arise whereby there must be made certain allocation for income tax purposes, is there anything that occurs to you as to why that has to be done?

A I never did inquire as to why they were prepared, sir. I have not come to any understanding on the matter at all.

Q Can you tell me, as far as the Income Tax Act is concerned, the difference between the terms "depreciation" and "depletion"?

A Roughly, I think the common distinction being that "depreciation" applies to property, plant and equipment, and "depletion" applies to a wasting asset.

Q And the term "depletion" in its application to a wasting asset is also applied to equipment is it not, to well equipment?

A Well if they call it "depreciation" calculated at "depletion" rates.

Q Mr. McLellan tells me they call it amortization. You as an Accountant know, I take it, that there are different rates for allowances permitted by the Government for income tax purposes with respect to depreciation and with respect to depletion and with respect to amortization, we will call it for want of a better term?

A Yes sir.

Q As I understand it so far as depreciation is concerned this applies particularly to plant and equipment. They have certain general maximum percentages they allow you to write off each year?

A Yes sir.

Q And then they also provide that you cannot deduct more for income tax purposes than you charge on the books so far as depreciation is concerned, is that not right?

A Generally speaking, yes, sir.

Q Now coming to this term "depletion", as I understand it so far as crude wells are concerned the income tax department allows the taxpayer to deduct as a deduction for depletion 33-1/3% of the net profit of the crude well. Are you familiar with that at all?

A I am not at all familiar with the tax regulations relating to well production at all, sir.

Q Do you know that there is a different rate or a different amount allowed to gas as distinguished from crude wells?

A Yes, sir.

Q Do you know that it is applied, that it is based on the amount of net profit for the year?

A I have that recollection, yes.

Q And if that were so, that would, then you as an accountant would expect to find a reason in that for these special statements being preparedin a company such as Royalite?

A It would be a reason. The Department might have other reasons in mind for asking for them, I do not know.

Q I am just asking you in a general way as an accountant would expect that if there are different rates for crude wells and different rates for gas and then another deduction for depreciation you as an accountant would expect to find that there would have to be made some computation as between departments?

A Only if the element of profit governs the rate of depreciation that is allowed.

Q Yes. Now then, as I understand it in your Exhibit 174 you show no item of expense with respect to the payment made to the Conservation Board by way of compensation and that Mr. McLellan's Exhibit 156 has such an amount in it.

A Yes sir.

Q Then I understood you to say that you did not think it was sound to show that as an expense. Now would you tell me why?

A No, sir, I did not intend to say that, if that is what I said. What I meant was that it always has been my view from many discussions that I have heard relating to the compensation matter that compensation, no matter how it was calculated, the quantum of damages should be charged against the production division of the Royalite Company and not against the Absorption Plant.

Q Why do you say it should be charged against the production division and not against any other part?

A Because as I understand that, correctly or incorrectly, the compensation matter arose due to the fact that the Royalite wells were overproduced.

Q That is the point I just wanted to get, the basis of your understanding. You base that on what somebody said in casual . . . . .

A And what I have heard here.

Q In other words what you have heard generally?

A Yes. A matter of general knowledge I believe, sir.

Q And so far as what the situation is you have not at first hand given thought or study to that, as to the legal situation or other matters of that kind?

A I have given a lot of study to it, but I have not any basis of information on which to base conclusions. I should

possibly go this much farther to say that I recognize from what I have heard that profits made in the absorption plant in the processing of that gas were an element of calculation arriving at the amount that was to be paid. But it still seemed to me that the reason for the payment would govern where it should be charged.

Q I think you already told us but I just want to put it on the record, as I understand it the expenses of the gas gathering lines north and south which are shown in Schedule 1 of your Exhibit 174 are substantially in agreement with the corresponding 1943 expenses shown on Schedules "C" and "D" of Mr. McLellan's Exhibit 156?

A I did not check that, sir, as a matter of fact.

Q All right.

A What I did check a long time ago was the operating costs of the gas wells' division in 1943 as a department of Royalite with the Madison costs for 1944 and found them substantially in agreement except where practical operations would indicate the necessity for a change.

Q One other thing, I gather from what you have said to my friend, Mr. Fenerty, that while as a matter of exemplification probably of the method you are not altogether enamoured of the volumetric basis as a guide to what should be charged to the absorption plant. Would that be a fair way to put it?

A Yes, sir.

Q Would you just tell us why you come to that conclusion?

A I think the effect of applying the volumetric method without qualification results in the curious anomaly which interested Mr. Fenerty and which interested me too and always has.

Q In other words it is the effect of it that leads you to maybe disapprove of it, is that right?

A Well I think you have to calculate the effect to determine the merits of the scheme.

Q Would you say it would be good practice for a regulatory board in fixing rates that say the Gas Company in Calgary is to charge Robin Hood Flour Mill to see what effect it is going to have on the Robin Hood Flour Mill?

A Yes.

Q And if the Robin Hood Flour Mill could not operate on a certain rate, do you think the Utility Board should lower it, is that right?

A I think the Utility Board would have in mind the effect, yes. Certainly if the rate to be set as a result of first calculation was such that it drove the industry away from the consumption of gas, I think the Board would certainly take that circumstance into account.

Q We will assume that the Burns' Plant can operate, we will say, at 2 cents per m.c.f. but that the Robin Hood Flour Mill cannot profitably operate and buy gas at 2 cents, with similarly known factors, they are the same, do you suggest the Burns' Company should pay two cents and the Robin Hood pay a lower figure?

A No, sir, that would be discrimination I would think. I certainly believe that the Board would be entitled to regard consumers of that class as a class and to weigh the effect of certain prices upon them and does so in striking schedules for retail sales.

Q But is not the effect on consumers, Mr. Hamilton, only of importance that if the rate worked out on a straight utility basis is beyond the ability of the consumer to pay?

A Well the ability to pay is a relative term, sir.

Q Well I am taking it in a commercial sense.

A In a commercial sense it does not mean whether you absolutely cannot pay it. It means whether you can fairly pay it.

Q It gets down to the matter of value of service and whether what you get can be served better by something else.

A That is another feature but you are speaking now of ability to pay. I still think that is a relative term. It does not mean absolutely can you pay or cannot you pay. It means can you fairly pay, reasonably pay.

Q Then you get back to reasonably pay. Does not that involve that particular point we discussed before, that suppose some business efficiently operated can pay and make money?

A Yes, sir.

Q And another one in exactly the same line of business, on account of certain circumstances maybe beyond its control, cannot pay that price, you do not suggest do you that the rate for the whole class should be brought down to the level where the poorest business can pay it?

A There are circumstances under which that would happen, sir, I think. I think the Board of Railway Commissioners for example have done that very thing.

Q I suggest to you that the Board of Railway Commissioners operate under a different method. It is not a straight utility statute.

A I said "under circumstances", sir. I believe that you would have to set out your hypothesis and weigh the effect of the circumstances.

Q Well if the rate is going to be fixed for any consumer on the basis of whether he is going to make money or a small percentage or a large percentage of profit with this commodity that is served to him, should not that rule be applied to

everybody?

A I did not suggest taking any single consumer. More properly I think you should take each class of consumer.

Q All right.

A I could carry it further . . . . .

Q Would not the same apply to classes of consumers?

A Yes, sir.

Q You say that the rates as between classes of consumers should be based on the amount of money or the percentage of money that they are going to make by the use of the commodity served by the utility?

A I said there were circumstances under which they might. Take an extreme case. Supposing you had one consumer who was taking 98% of the total Turner Valley supply of dry gas and he could take that gas and continue to operate and would continue to operate at 5 cents, but would find his operation was unprofitable at 6 cents and he would close down. It would be in the interests of everybody that the price be fixed at 5 cents. In an extreme case like that you can see what I mean.

THE CHAIRMAN: I do not want to interrupt a very interesting discussion but is it not a fact that I have to determine where the burden must fall and then if I may use the expression "the chips must fall where they may".

MR. CHAMBERS: The only reason I brought it out is we have had a procession of witnesses in the box giving opinions as to why this method is right or wrong. Frankly I take the position that probably they are in the expert field and I think that they having expressed their opinions we could test them. But I am quite prepared to leave that.

Q Just one word. I want to talk to you about this book depreciation because my friend Mr. Fenerty stressed it again. I think you told us before, Mr. Hamilton, you have done a certain amount, a considerable amount of reading and study and giving thought to this matter of regulation. You have run across this, I would imagine, that profits earned, realized by the utility or company prior to regulation are its property and cannot be taken away from it. Have you run across a statement like that?

A I have run across the statement, yes.

THE CHAIRMAN: Even I will agree with that.

Q MR. CHAMBERS: I am suggesting to you, Mr. Hamilton, this for the purposes of discussion, that that same rule if it is sound is inherent in this business of book depreciation?

A Yes, sir.

Q Because the more, ordinarily the more that the company takes for depreciation in a year there is less available for dividends naturally?

A Yes, sir.

Q Thanks.

THE CHAIRMAN: Mr. Blanchard?

MR. BLANCHARD: Nothing, sir.

THE CHAIRMAN: Any further cross-examination of Mr. Hamilton?

Q BY MR. STEER: You would not say that book depreciation that has been taken is a matter of no importance if what you are considering is a regulated company, would you?

A Oh no, sir.

THE CHAIRMAN: Thank you, Mr. Hamilton.

RUSSELL D. MERCER, having been recalled, direct examination by Mr. Chambers continued:-

Q Mr. Mercer, you have certain statements with you, I believe, which are statements prepared and submitted to the Income Tax authorities in connection with the income tax returns of the Company, and standard profits, is that right?

A Yes, just as to the income taxes, Mr. Chambers.

Q Now before we go into the statements, I would like to discuss with you for a moment the situation as to why you got out those statements for income tax purposes, am I right in this, that in a company such as the Royalite the Income Tax authorities allow, first of all, certain deductions with respect to depreciation?

A Yes.

Q And that depreciation is applicable to the write-up on your buildings and your plant and equipment, is that right?

A That is quite right.

Q And then in addition to that, and by the way, they have laid down certain rules, one of which is that there is a maximum per cent each year that they will allow you to write off?

A That is quite right.

Q And if you do not book it you cannot write it off, is that right?

A If you do not book it you cannot claim it.

Q That is right?

A Yes.

Q Now, in addition to depreciation as such, as I understand it, in a Company such as Royalite, which operates crude oil wells and gas wells or gas cap wells, the Income Tax authorities allow you certain other deductions?

A Yes.

Q Commonly known as "depletion", is that right?

A Yes, there is a depletion allowance, also amortization.

Q Tell us the difference between the two, if you will?

A Amortization is an allowance for Income Tax purposes against the costs of drilling wells, that is the amortization.

Q That is amortization?

A Yes.

Q The costs of the drilling?

A Yes.

Q Yes?

A And depletion is an allowance for Income Tax purposes derived or arrived at through application of the revenue obtained from the leases.

Q Yes. Now am I right in this, that the depletion allowance with respect to crude oil wells, is one percentage and the allowance with respect to gas wells or gas cap wells is another percentage, is that right?

A Yes.

Q Now will you tell us what is the allowance for crude wells and how they are divided?

A In connection with the crude well allowance for depletion, it is 33-1/3% of the net profit.

Q Of what?

A Of the crude well leases.

Q For the year?

A For the year.

Q Yes?

A In connection with the gas wells it is 25% of the net profit derived from the leases.

Q Now, and these statements which you have with you, as I understand it, were brought into being and prepared for the purposes of computing the allowances which you claimed for

depletion?

A Depletion allowances, yes, as between the gas wells and the crude wells.

MR. CHAMBERS: That is all I have.

.....

CROSS-EXAMINATION BY MR. FENERTY

Q Mr. Mercer, I want you to disregard the statements prepared in 1943 with reference to, especially for submission to the Conservation Board, and I want to direct you again to the statement of Mr. Kirkpatrick on Page 1901, where he says that statements were prepared once annually "to my knowledge showing total operations broken down for various purposes", commencing in 1940 and 1939; now have you those particular statements referred to?

A I have found that the statements referred to, refer first to the year 1940.

Q 1940?

A Yes, and I have that statement here.

Q And have you with you all of the statements which you have knowledge of, referred to by Mr. Kirkpatrick, other than the special ones prepared for the Conservation Board?

A I did not bring the whole corporate income tax returns.

Q No, but the actual statements?

A I did bring the statements referred to, or as I understood, referred to by Mr. Kirkpatrick.

Q So far as you know these contain all those statements?

A Yes.

Q Other than the ones for the Conservation Board?

A Quite.

Q Will you produce those. (Witness produces same).

WITNESS: How far do you want me to go, do you want me to read the whole thing into the record?

MR. FENERTY: I think all I am entitled to is to have the statements put in and if we want to cross-examine on them, we will have to look at them, but all I want for the moment is to have them marked.

THE CHAIRMAN: What is the first one you have, Mr. Mercer?

A This is a statement of the Royalite Oil Company Limited, being a calculation for depletion for the year 1940.

THE CHAIRMAN: That will be marked as Exhibit 175.

WITNESS: This brings up the question, Mr. Blackstock, these have not been prepared to be submitted as part of our corporate accounts for income taxes and it is the only copy we have.

THE CHAIRMAN: Oh, we will let you have them back.

MR. CHAMBERS: Are they too extensive to have copies made?

THE CHAIRMAN: If you wish we can mark the originals and you can have them back and if you wish to make copies and then keep the originals, then we can use the copies.

WITNESS. That will be satisfactory, sir.

Q MR. FENERTY: Are they all there?

A That is the complete schedule for the one year, 1940.

Q And then you have the succeeding years?

A I have like statements for the year ending December 31st, 1941; for the year ending December 31st, 1942; for the year ending December 31st, 1943.

THE CHAIRMAN: Perhaps we should mark these all as one exhibit.

Q MR. FENERTY: Do you happen to have 1944 with you?

A And for the year 1944.

MR. FENERTY: We might as well have the real record while we are at it.

THE CHAIRMAN: We had better mark these as one exhibit, the five statements produced.

FIVE STATEMENTS PRODUCED HERE MARKED AS EXHIBIT 175.

MR. CHAMBERS: Will it be necessary to keep these?

THE CHAIRMAN: These can be given back to Mr. Mercer, and copies can be made. We will either have to have these or we will have to have copies.

MR. FENERTY: I do not want, of course, to attempt to cross-examine on these at the moment, but I just want to ask one question without even looking at them.

Q MR. FENERTY: Can you tell me offhand whether any of these statements now produced purport to show a division of gathering costs as between dry gas operations and gasoline operations on a basis of 60-40 or 50-50 or something of that nature?

MR. CHAMBERS: Now, if you are going to refer to the information in the statements I think you should use the statements.

MR. FENERTY: That is all right, but the only reason I wanted it was this, that if they do not, I want to ask if there are any other statements, because Mr. Kirkpatrick referred to others. I do not want any misunderstanding. Surely you cannot object to that.

Q MR. FENERTY: Will you point out to me on the statements, Mr. Mercer, any distribution of gathering costs between dry gas operations and gasoline operations on any basis?

A I see here for the year 1940 the gas gathering lines, North

expenses, and by the way, I am speaking of "expenses", this is the taxable amount. These items that are covered in here are amounts which have been allowed for income tax purposes., They might not necessarily be the actual amounts according to the books.

Q Mr. Mercer, so far as I am concerned, you do not need to explain it each time. We will assume with you, that every statement is for a special purpose, but all I want is the fact, that it shows something?

A Of the $21,820.06, an amount of $265.59 was applied to crude oil wells; $17,841.89 was applied to gas wells.

Q Yes?

A And $3,712.58 was applied to other operating income and expenses.

Q And can you tell me from looking at these figures whether they were apportioned on what we have been calling the volumetric basis or some other basis?

A For the purposes of calculation of income taxes, they would have been applied or distributed, I believe, on the realization method.

Q That is what I wanted to get?

A Yes.

Q So you think these are the only statements in existence referring to the realization basis of distribution; the only reason I am asking that was that I understood Mr. Kirkpatrick to say as a matter of his recollection that the statement he was referring to did show distribution on the realization method and I wanted to make sure these were the ones he was talking about?

A These, I am sure, are the statements he refers to.

MR. FENERTY: Thank you.

THE CHAIRMAN: Then, Mr.Fenerty, do you wish to have an opportunity of examining these, for the purposes of a detailed

cross-examination?

MR. FENERTY: Yes, I do. I do not say I want to ask any further questions but I would certainly like to have an opportunity of looking at them first before I decide on anything.

THE CHAIRMAN: Quite right.

MR. FENERTY: There may or may not be a number of questions.

THE CHAIRMAN: Quite so. Anyone else prepared to cross-examine Mr. Mercer now?

Then that leaves us without anything to go on with further this morning.

Your Order, Mr. McDonald, for the South End is not ready yet?

MR. McDONALD: No sir, we are down to one point.

THE CHAIRMAN: All right then, what about tomorrow? I have given Mr. Johanson the right to start tomorrow morning so that he can finish and get home. Then we can follow that with any further examination or cross-examination of Mr. Brownie and the cross-examination of Mr. Mercer.

Now does anyone know of any other business, than these three things which I have mentioned? If not, and if we are not finished by 12.30 tomorrow we will then adjourn until 2 o'clock and sit in the afternoon and try to finish tomorrow. Is that agreeable to everyone?

MR. STEER: Yes.

THE CHAIRMAN: Then we will adjourn until tomorrow morning.

(The Inquiry was here adjourned to be resumed at 9.30 A.M. April 24th, 1946).